86-446

No.

Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

FLYNT DISTRIBUTING CO., INC.,

Petitioner,

v.

JACKIE COLLINS LERMAN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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September 16, 1986

QUESTION PRESENTED

Did the Court of Appeals err in departing from the "long practice in the Federal courts" and holding, *as a matter of law*, that interest expenses necessarily incurred in collateralizing an appeal bond are "not permissible items of taxable appellate costs"?

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

FLYNT DISTRIBUTING CO., INC.,

Petitioner,

v.

JACKIE COLLINS LERMAN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Flynt Distributing Co., Inc., respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit, entered in the above-entitled proceeding on April 29, 1986 (rehearing denied June 19, 1986).

The judgment sought to be reviewed vacates the taxation by the District Court of $64,821 in interest expenses (in addition to bond premiums) necessarily incurred by petitioner, a national magazine distributor, to collateralize a supersedeas bond in order to successfully seek appellate review and the reversal of a "mega-verdict" on First Amendment grounds. *Lerman v. Flynt Distributing Company, Inc.*, 745 F.2d 123 (2d Cir. 1984), *cert. den.*, ___ U.S. ____, 105 S.Ct. 2114 (1985).

The costs in question were taxed by the District Court after the "careful scrutiny" required by this Court's opinion in *Farmer v. Arabian American Oil Co.*, 379 U.S. 227 (1964), including an evidentiary hearing and reduction of petitioner's

actual costs to reflect interest which the District Court concluded petitioner should have earned on the sum in question during the pendency of the appeal.

The Court of Appeals' holding that petitioner's borrowing expenses are not taxable as a matter of law departs from well-settled federal practice and squarely conflicts with the rule of the Ninth Circuit to the contrary, most recently articulated in *Sunkist Growers, Inc. v. Winckler and Smith Citrus Products,* 316 F.2d 275 (9th Cir. 1962), as well as with the Second Circuit's own prior opinion in *Trans World Airlines, Inc. v. Hughes,* 515 F.2d 173 (2d Cir. 1975), *cert. den.,* 424 U.S. 934 (1976), which cited *Sunkist Growers* with approval.

Jurisdiction

The judgment and opinion of the Court of Appeals for the Second Circuit was entered on April 29, 1986. A timely petition for rehearing or rehearing in banc was denied on June 19, 1986. This Court's jurisdiction is invoked under 28 U.S.C. Section 1254(1) and Rule 19 of the Rules of this Court.

Opinions Below

The opinion of the Court of Appeals for the Second Circuit, not yet reported, and the opinion of the District Court for the Southern District of New York, not reported, are reprinted in the Appendix hereto at A1 and A9, respectively. The earlier related opinion of the Court of Appeals, *Lerman v. Flynt Distributing Co., Inc.,* is reported at 745 F.2d 123 (2d Cir. 1984), *cert. den.,* ___ U.S. ____, 105 S.Ct. 2114 (1985).

Statute Involved

Federal Rule of Appellate Procedure 39(e), 28 U.S.C.:

> Costs.
>
> (e) Costs on Appeal Taxable in the District Courts. Costs incurred in the preparation and transmission

of the record, the cost of the reporter's transcript, if necessary for the determination of the appeal, the premiums paid for the cost of supersedeas bonds or other bonds to preserve rights pending appeal, and the fee for filing the notice of appeal shall be taxed in the district court as costs of the appeal in favor of the party entitled to costs under this rule.

Statement of the Case

In June, 1983, respondent, the world-famous author Jackie Collins, recovered an unprecedented $40 million judgment against petitioner, a national magazine distributor, in the United States District Court for the Southern District of New York.[1] The judgment, remitted to $10 million by the District Court (Werker, D.J.), awarded respondent massive compensatory and punitive damages for the unauthorized use of respondent's name in violation of New York Civil Rights Law §§50 and 51. On appeal, the United States Court of Appeals for the Second Circuit reversed the judgment in respondent's favor and ordered her complaint dismissed as a matter of federal constitutional law. 745 F.2d 123 (2d Cir. 1984), *cert. den.*, ___U.S. _____, 105 S.Ct. 2114 (1985).

Prior to its successful appeal to the Court of Appeals, petitioner sought post-trial relief in the District Court, including a stay of execution of the judgment pending appeal. *Inter alia*, petitioner noted that regardless of the resolution of the federal constitutional question presented, the extraordinarily excessive $40 million verdict in respondent's favor could not possibly withstand appellate review on a number of grounds, including respondent's counsel's deliberate inflammation of the passion and prejudice of the jury by a verbal attack on petitioner's corporate principal, Larry Flynt, guaranteed to engender appellate criticism and reversal. An essentially identical attack on Mr. Flynt by respondent's counsel in earlier litiga-

[1] The jurisdiction of the District Court was invoked under 28 U.S.C. §1332.

tion had led to precisely this result. *See, Guccione v. Hustler Magazine, Inc.*, 7 Med. L. Rptr. 2077 (Ohio Ct. App. 1981), *cert. den.*, 459 U.S. 826 (1982) ($39 million verdict, remitted to $5.05 million, set aside and new trial ordered in light of inflammatory summation of Norman Roy Grutman).[2]

In support of its motion for a stay pending appeal, petitioner also noted its undisputed financial inability to fully (or even substantially) bond the then-$40 million judgment pending appeal, and the fact that it would either be forced into bankruptcy or put out of business if the judgment were executed upon. Instead, petitioner offered a number of alternatives, including a receivership, to reasonably secure respondent pending appeal. Despite the overwhelming likelihood of reversal of the huge verdict in her favor, respondent unreasonably rejected each alternative offered by petitioner upon the alleged ground that only a surety bond would represent "real" security to respondent—*i.e.*, security which would not prove "illusory" in the event of bankruptcy.

Employing a variant of the procedure approved by the Court of Appeals in *Trans World Airlines, Inc. v. Hughes*, 515 F.2d 173 (2d Cir. 1975), *cert. den.* 424 U.S. 934 (1976), for fixing the terms and conditions of such a stay in a case involving a "mega-verdict" far beyond the financial ability of the losing party to bond, the District Court ultimately succeeded in achieving agreement upon a $1 million surety bond. During these proceedings, there was full disclosure, on the record, that in order to secure the requisite bond, petitioner would have to borrow $1 million against a line of credit with Trefoil Capital Corp. (a subsidiary of Fidelity Bank of Philadelphia, Pennsylvania) guaranteed by petitioner's parent corporation, L.F.P., Inc., and corporate principal, Larry Flynt.

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[2] *See, also, Guccione v. Hustler Magazine, Inc.*, ___ F.2d ____, Slip Op. 5483, at 5487 (2d Cir., August 29, 1986), in which the Second Circuit expressly criticizes respondent's counsel's "melodramatic appeals to jurors' passions and prejudices" in our case.

Balancing the competing interests of the parties in the context of petitioner's plea that it could not secure even a $1 million surety bond without borrowing, the District Court expressly ruled that in the event of a successful appeal by petitioner, respondent would be responsible for *all* of the expenses incurred in securing "that surety bond":

> THE COURT: * * * You [petitioner's counsel] are saying you [petitioner] will be throwing another million in the pot you will not be able to recoup, but if you . . . reverse this . . . verdict on appeal . . . *whatever you pay for that surety bond is going to come out of the plaintiff.*
>
> [A12; bracketed material and emphasis added].[3]

To procure the immediate posting of the surety bond required by the District Court, petitioner's lender transferred the $1 million collateral directly to the surety, Aetna. Because Aetna does not pay interest on collateral deposited with it, petitioner (with Aetna's permission and assistance) attempted to substitute interest-bearing collateral in the place and stead of the $1 million held by Aetna, *e.g.*, either an interest-bearing certificate of deposit or a letter of credit in turn secured by an interest-bearing deposit.

It was initially thought that the surety bond would be collateralized by such a letter of credit (*i.e.*, a letter of credit in turn secured by an interest-bearing deposit), however, the District Court permitted less than twenty-four hours for the posting of the bond after agreement was reached on the amount, leaving insufficient time for such arrangements to be made *ab initio*. In any case, later events proved that an effort to post such a letter of credit would have been futile and self-defeating.

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[3] The Court of Appeals posthumously misinterpreted Judge Werker's remarks, completely out of context, to make it seem as if His Honor was referring to the bond premium. The bond premium, however, was never in issue, and the Court of Appeals has unfairly and blatantly misread the record in this regard in order to justify its result.

At the evidentiary hearing held by the District Court, the Aetna Bond Superintendent responsible for this matter testified that, after initially depositing $1 million with Aetna, petitioner at all times cooperated with Aetna and acted in a commercially responsible manner, making at least five (5) separate efforts to substitute interest-bearing collateral instruments issued by (1) Bank of America, (2) Fidelity Bank, (3) Dime Savings Bank of New York, (4) Beverly Hills Bank, and (5) Wells Fargo bank. (A12-13).

Aetna, however, unilaterally rejected each and every substitute collateral instrument proffered by petitioner. Its reasons for doing so ranged from insufficient negotiability (Bank of America, Fidelity Bank, and Dime Savings Bank of New York) to objections to the size of the issuing bank (Beverly Hills Bank) and the place at which the instrument was to be held (Wells Fargo Bank). (A12-13).

Accordingly, Aetna continued to hold petitioner's $1 million, without interest, until the surety bond was exonerated by order of the Court of Appeals (over respondent's objection) in September, 1984.

During the period the surety bond was in place, petitioner incurred $183,751 in interest expenses charged by its lender with respect to the $1 million borrowed and deposited with Aetna to secure the bond. Following its successful appeal, petitioner sought to tax this interest expense as one necessarily incurred in posting security pending appeal, in addition to the bond premium. In the alternative, petitioner requested taxation of $64,821, the differential between the expense incurred by it ($183,751) and "the interest that could [have been] earned" on the $1 million bond collateral at money market rates ($118,930).

Eminently faithful to the requirement of *Farmer v. Arabian American Oil Co.*, 379 U.S. 227 (1964), that such a request be subject to "careful scrutiny," the District Court (Griesa, D.J.) subjected petitioner's application to rigorous review, holding an evidentiary hearing (at which the Aetna Bond Super-

intendent testified), and requiring petitioner to fully particularize its claim for alternative relief in supplementary papers, including a calculation by an officer of Citibank, N.A. of the interest which could have been earned on the $1 million bond collateral at money market rates.

Respondent called no witnesses and offered no evidence in opposition to petitioner's application.

After rendering an opinion holding that petitioner was entitled to recover its interest expense, less the interest which could have been earned on the $1 million at money market rates (A9), the District Court entered a supplemental judgment for petitioner in the sum of $64,821, plus interest, in October, 1985. (A11). Respondent bonded this judgment pending appeal to the Second Circuit.

On appeal, the Court of Appeals reversed, holding petitioner's interest expense to be a non-taxable cost as a matter of law. (A1).

This construction of Federal Rule of Appellate Procedure 39(e) departs from long-standing federal practice and squarely conflicts with three (3) prior decisions of the Court of Appeals for the Ninth Circuit, as well as with the Second Circuit's own prior decision in *Trans World Airlines, Inc. v. Hughes, supra.*

The conflict between the circuits resulting from the Court of Appeals' decision was expressly called to that court's attention in a petition for rehearing or rehearing in banc, which was denied without opinion. (A14).

REASONS FOR GRANTING THE WRIT

The decision of the Court of Appeals for the Second Circuit departs from established practice and has created a clear conflict between the circuits with respect to an issue often determinative of litigation, and especially critical in First Amendment cases: financial responsibility for the cost of borrowing necessary to collateralize federal appeal bonds.

The paramount importance of access to appellate review and remedies in First Amendment litigation, such as that at bar, cannot be overstated. *See, Bose Corporation v. Consumers Union of U.S., Inc.*, 466 U.S. 485, 499 (1984), in which this Court reiterated the vital role of the appellate courts in insuring that judgments against media defendants "[do] not constitute a forbidden instrusion on the field of free expression." Appellate review is all the more important in cases, such as that at bar, in which the successful party has been awarded a "mega-verdict" in the trial court, far beyond the financial ability of the media defendant to satisfy and chilling for all others to even contemplate:

> No doubt such an enormous verdict chills media First Amendment rights. But a verdict of this size does more than chill an individual defendant's rights, it deep-freezes that particular media defendant permanently.
>
> *Lerman v. Flynt Distributing Co., Inc., supra,* 745 F.2d at 141.

Recognizing that "payment of the [bond] premium is not the only burden which necessity imposes" in procuring a stay pending appeal, the Ninth Circuit has long permitted the taxation of costs, including the costs of borrowing, necessarily incurred in preserving the right to appeal.

In *The Europe,* 190 F. 475 (9th Cir. 1911), the Court of Appeals propounded the "as necessary as payment of the premium" test for judging the taxability of costs "over and above the bonding surety rate." *The Europe* arose out of the taxation (in addition to the bond premium) of the "expenses incurred in arranging with bankers in France and New York to furnish the indemnity [*i.e.,* collateral] which the bond company exacted." As explained by the Court of Appeals:

> To these additional expenses objections are specially urged. It is said that such expenses are unusual and unnecessary. . . . The answer to these strictures is that it has always been usual for courts to mulct the defeated party in a lawsuit for the costs of the litigation, including the necessary disbursements of his adversary.* * * And *payment of the [bond] premium is not the only burden which necessity imposes.* Bonding companies are not like insurance companies. They sell their credit only; they do not assume obligations without being fully indemnified. *In this case the expense of providing indemnity was as necessary as payment of the premium.*
>
> (190 F. at 481; emphasis added).

The Europe was expressly relied upon by the Court of Appeals in *Kemart Corp. v. Printing Arts Research Laboratories, Inc.,* 232 F.2d 897 (9th Cir. 1956), in which the Ninth Circuit reiterated that expenses incurred in bonding an appeal "over and above the bonding surety rate" are taxable in the exercise of discretion:

> The general subject of entering as costs the sums paid for surety, over and above the usual fee therefor, was discussed in The Europe, 9 Cir., 1911, 190 F. 475. In the cited case it was held by this court that *the expense of obtaining a bond, as well as the regular premium paid to the bonding company, could be taxed as costs.* * * *

> *There would then seem to be no question as to the trial court's power to assess as costs, money paid out for a bond over and above the bonding surety rate,* but the allowance or rejection is subject to the trial court's sound discretion, and the trial court is not bound by the reasons given by the clerk for his ruling. * * *
>
> (232 F.2d at 899-900; emphasis added).

In *Sunkist Growers, Inc. v. Winckler & Smith Citrus Products,* 316 F.2d 275 (9th Cir. 1962), the Court of Appeals reaffirmed the vitality of both *The Europe* and *Kemart, supra,* and awarded costs representing *the net cost of borrowing $2 million* in order to post security in lieu of a bond pending appeal. Because the borrowed money was used to purchase interest-bearing security, the *Sunkist Growers* court simply subtracted the interest earned from the interest paid, arriving at a net expense of $150,776.18.

Prior to the decision of the Court of Appeals in *Lerman* now sought to be reviewed, it appeared that the Second Circuit had adopted the Ninth Circuit rule as to the taxability of necessary costs "over and above the bonding surety rate" in *Trans World Airlines, Inc. v. Hughes,* 515 F.2d 173 (2d Cir. 1975), *cert. den.,* 424 U.S. 934 (1976), in which the Second Circuit, expressly citing *Sunkist Growers, supra,* permitted the taxation of the expenses of posting a letter of credit in lieu of a supersedeas bond, *together with* the costs of quarterly net worth audits *and* security to the bank that issued the letter of credit. 515 F.2d at 176-177. Indeed, here, the District Court clearly adapted and employed the *Sunkist Growers* "net expense" calculation of allowable interest costs and expressly cited *Trans World Airlines, Inc. v. Hughes,* as its authority for doing so. (A10).

A similar conclusion was reached by the Supreme Judicial Court of Massachusetts in *Creed v. Apog,* 377 Mass. 522, 386 N.E.2d 1273 (1979), in which that court, citing *Trans World Airlines, Inc. v. Hughes* and *Kemart, supra,* permitted the taxation of the $19,500 cost of obtaining a bank letter of credit

to secure a surety bond in addition to the $5,850 cost of the bond premium. In overturning the opinions of the trial and intermediate appellate courts, both of which had held such costs non-taxable as a matter of law, the Supreme Judicial Court relied upon what it termed "long practice in the Federal courts":

> *Such costs have been awarded to prevailing parties by long practice in the Federal courts. Newton v. Consolidated Gas Co.*, 265 U.S. 78, 86 (1924). *Trans World Airlines, Inc. v. Hughes*, 515 F.2d 173 (2d Cir. 1975), cert. denied, 424 U.S. 934 (1976). *Kemart Corp. v. Printing Arts Research Laboratories*, 232 F.2d 897, 899-900 (9th Cir. 1956). See 6 Moore's Federal Practice par. 54.77[8] (2d ed. 1976); 10 C. A. Wright & A. R. Miller, Federal Practice and Procedure §2677 at n.86 (1973). * * *
>
> 377 Mass. at 525, 386 N.E.2d at 1275 (emphasis added).

See, also, Melvin v. West, 120 So.2d 233 (Fla. Dist. Ct. App. 1960), in which a Florida intermediate appellate court, citing *Kemart* and *The Europe, supra*, held a $7,000 charge for partially collateralizing a $350,000 supersedeas (in addition to a $2,062.50 bond premium), as well as fees and taxes incurred in recording a mortgage given to collateralize the bond, fully taxable as *necessary* expenses incurred to prevent the plaintiff from "levy[ing] on all the property of the defendant in satisfaction" of the judgment appealed from prior to appellate review.

As explained by the *Creed* court, the long-standing federal practice, exemplified by the Ninth Circuit precedents and *Trans World Airlines, Inc. v. Hughes, supra*, "helps preserve the balance between the plaintiffs' rights to secure possible judgments and the defendants' rights to be free of what proves to be unnecessary attachments." 377 Mass. at 526, 386 N.E.2d at 1275. The Second Circuit, however, has now abruptly rejected *sub silencio* the "long practice in the

Federal courts" with respect to assessing the taxability of costs such as those incurred in this case, and has substituted for the Ninth Circuit rule a blanket holding that:

> The issue on this appeal is *whether all or even a portion of the interest charges incurred in borrowing funds used as collateral to secure a supersedeas bond are taxable as appellate costs.*
>
> * * *
>
> Because *none of the interest is taxable as costs,* we reverse. . . .
>
> * * *
>
> FDC's borrowing expenses, sought in addition to the premium on a supersedeas bond, is *not a permissible item of taxable appellate costs.*
>
> (A2, A3, A7; emphasis added).

This unprecedented holding—for which the Second Circuit cites no authority other than general propositions of law not in issue—squarely conflicts with the precisely opposite conclusion of the Court of Appeals for the Ninth Circuit in *Sunkist Growers, supra,* as well as with the Second Circuit's own prior approval of the Ninth Circuit approach. Moreover, the Second Circuit has refused to address the conflict between the circuits which it has created, denying without opinion the petition for rehearing below which expressly called the attention of the Court of Appeals to the consequence of its decision. Review by the Supreme Court is thus essential to restore uniformity to the interpretation and practical application of Federal Rule of Appellate Procedure 39(e) in this most critical area of concern, in which a litigant can easily win the legal battle for appellate review, only to lose the financial war and be put out of business, forced into bankruptcy or otherwise severely or irreparably prejudiced by failing to shift the true cost of obtaining appellate review to the adverse and ultimately losing party.

CONCLUSION

In the twenty-four (24) years which have passed since this Court last addressed the taxation of appellate costs in *Farmer v. Arabian American Oil Co., supra,* the advent of "mega-verdicts," especially (but not only) in First Amendment cases, has made the taxability of interest expenses incurred to borrow collateral to secure appeal bonds a critical and timely issue, fully justifying review by this Court. Here, moreover, the demonstrable departure from long-standing federal practice and resulting conflict between the circuits in this case, underscore the necessity and appropriateness of Supreme Court review.

As is made clear by the discussion, *supra,* there was in this case absolutely no abuse of discretion by the district judge in awarding petitioner the interest costs it necessarily incurred in securing the $1 million bond at bar. (Indeed, if anything, petitioner should have been awarded its entire cost, without deduction for interest it had no opportunity to earn despite its best efforts in this regard.) Respondent unreasonably demanded an excessive bond, far beyond the financial ability of petitioner to post, and grossly disproportionate in view of the lack of merit to respondents' case.[4] Furthermore, petitioner was *not* awarded "every expense" it incurred in the defense of *Lerman,* nor was the District Court a mere "rubber stamp" for the judgment clerk. To the contrary, the District Court was eminently faithful to the "careful scrutiny" standard which is at the heart of this

[4] *Inter alia,* the immensely excessive verdict in respondent's favor (i) was fatally flawed as a matter of constitutional law, *see,* 745 F.2d at 138-141; (ii) was clearly engendered by appeals to the passion and prejudice of the jury, *see,* 745 F.2d at 141; and (iii) was barred by both respondent's failure of proof under New York's "gross irresponsibility" standard for imposing liability on private parties (assuming, *arguendo,* that respondent seriously believed she was not a public figure), and her prior $100,000 settlement with petitioner's predecessor distributor. *See,* Memorandum in Opposition to Petition for Writ of Certiorari, at 17, *Lerman v. Flynt Distributing Co., Inc., cert. den.,* ___ U.S. ____, 105 S.Ct. 2114 (1985) (October, 1984 Term, No. 85-1359).

Court's requirement of "sparing" and "restrained" awards of costs not specifically allowed by statute. *Farmer*, 379 U.S. at 235. Petitioner was required to explain the necessity of incurring the cost sought to be taxed at several oral arguments and a full blown evidentiary hearing, and the District Court was meticulous in protecting respondent, even to the point of denying petitioner's original motion and directing that its alternative application for the "interest differential" be made on a full set of additional papers, including an explanation of how the "interest differential" was calculated.

For all of these reasons, a writ of certiorari should issue to review the decision and judgment of the Court of Appeals for the Second Circuit.

Respectfully submitted,

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DAVID SUTTON
Of Counsel

September 16, 1986

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[5] In compliance with Supreme Court Rule 28.1, petitioner states that it is a wholly owned subsidiary of L.F.P., Inc., and an affiliate of Hustler Magazine, Inc., Gentleman's Companion, Inc., MCA Advertising, Flynt Subscription Company, Flynt Disc, and Hustler Productions, Inc.

Opinion of the Court of Appeals Dated April 29, 1986 and Judgment Entered Thereon April 29, 1986

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 647, 705—August Term 1985

Argued: January 30, 1986 Decided: April 29, 1986

Docket Nos. 85-7775, 85-7961

JACKIE COLLINS LERMAN,

Plaintiff-Appellant-Cross-Appellee,

—v.—

FLYNT DISTRIBUTING CO., INC.,

Defendant-Appellee-Cross-Appellant.

Before:

VAN GRAAFEILAND, NEWMAN, and KEARSE,
Circuit Judges.

Appeal and cross-appeal from a supplemental judgment of the District Court for the Southern District of

New York (Thomas P. Griesa, Judge) awarding appellee appellate costs.

Reversed on the appeal; affirmed on the cross-appeal.

NORMAN ROY GRUTMAN, New York, N.Y. (Jeffrey H. Daichman, David E. Bamberger, Grutman Miller Greenspoon Hendler & Levin, New York, N.Y., on the brief), *for plaintiff-appellant-cross-appellee.*

EDWARD S. RUDOFSKY, New York, N.Y. (Enid W. Langbert, John M. Barth, Zane and Rudofsky, New York, N.Y., on the brief), *for defendant-appellee-cross-appellant.*

JON O. NEWMAN, *Circuit Judge*:

The issue on this appeal is whether all or even a portion of the interest charges incurred in borrowing funds used as collateral to secure an appellate supersedeas bond are taxable as appellate costs. The issue arises on an appeal by Jackie Collins Lerman from a supplemental judgment of the District Court for the Southern District of New York (Thomas P. Griesa, Judge) granting Flynt Distributing Company, Inc. ("FDC") $64,821 in appellate costs. This sum represents a so-called "interest differential" between the amount FDC paid as interest in borrowing

money to collateralize a supersedeas bond and the amount FDC could have earned had the collateral been invested at prevailing money market rates for the period of the bond. Lerman contends that no portion of the interest is a taxable cost under Fed. R. App. P. 39(e). FDC cross-appeals and seeks an increase of the supplemental judgment to $183,751 to recover its total interest cost. Because none of the interest expense is taxable as costs, we reverse on the appeal and affirm on the cross-appeal.

Background

This dispute arises in the aftermath of our decision in *Lerman v. Flynt Distributing Co.*, 745 F.2d 123 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2114 (1985). In that decision, familiarity with which is assumed, we reversed a $10 million judgment Lerman had obtained against FDC. In connection with the prior appeal, the late Judge Henry F. Werker had initially ordered FDC to post a $10 million supersedeas bond. The parties subsequently agreed to a bond of $1 million. In describing this agreement to the District Court, FDC's counsel represented that the bond would be backed by a letter of credit. It subsequently developed that FDC could not secure a letter of credit. Instead, without notifying the District Court or Lerman, FDC collateralized a bond issued by Aetna Casualty and Surety Co. with a deposit of $1 million cash that FDC had borrowed. By the terms of the bond, Aetna was not obligated to pay FDC any interest on the collateral. It apparently was FDC's expectation to replace the cash with a certificate of deposit, the interest from which would have belonged to FDC. However, substitute collat-

eral was never obtained, and FDC's borrowed cash remained on deposit with Aetna for the life of the bond, without earning any interest for FDC.

After this Court reversed the judgment in Lerman's favor, FDC moved for the release of its supersedeas bond. Its motion, which was granted on September 25, 1984, for the first time alerted both Lerman and the District Court that the bond had been secured by borrowed cash and that the bond's collateral had earned no interest since it was deposited with Aetna in July 1983. FDC filed a bill of costs that included $183,751 for "[i]nterest cost on bond." FDC claimed to have borrowed the $1 million at an annual interest rate of 15 percent. The Clerk of the District Court taxed costs in the amount of $9,280.26, allowing $5,312.50 for the bond premium but disallowing FDC's claimed interest expense. FDC moved to retax costs, seeking its borrowing expense or, alternatively, the difference between its expense and $118,930, the amount FDC alleged the $1 million would have earned at prevailing money market rates during the relevant period. After initially denying the motion entirely, Judge Griesa granted FDC's request for the interest differential of $64,821, a ruling from which both sides appeal.

Discussion

As a rule, a district court has broad discretion in awarding costs, *Farmer v. Arabian American Oil Co.*, 379 U.S. 227 (1964), and an award of costs may be set aside only for abuse of discretion. *Id.*; *United States v. Procario*, 361 F.2d 683, 685 (2d Cir. 1966) (per curiam). This discretion, however, "should be sparingly exercised

with reference to expenses not specifically allowed by statute." *Farmer, supra*, at 235.

Costs of appeal taxable in the district courts are enumerated in Fed. R. App. P. 39(e), which specifically provides for "the premiums paid for cost of supersedeas bonds or other bonds to preserve rights pending appeal." The Rule makes no mention of other expenses incidental to obtaining bonds, such as the interest cost claimed here. The District Court, in allowing certain items on FDC's initial bill of costs, approved a $5,312.50 bond premium, as provided for in Rule 39(e). Lerman paid this amount, which was never in dispute.

In awarding $64,821 in "interest differential," the District Court cited *Trans World Airlines, Inc. v. Hughes*, 515 F.2d 173 (2d Cir. 1975), *cert. denied*, 424 U.S. 934 (1976). We held in that decision that certain expenses, incurred by Hughes Tool Co. in obtaining a stay of execution pending its ultimately successful appeal of a $145 million default judgment entered by the trial court in T.W.A.'s favor, were taxable against T.W.A. despite the fact that no specific provision was made for those costs in the Federal Rules of Appellate Procedure. The expenses included the fee paid on a $75 million letter of credit, the cost of audits made to guarantee that Hughes Tool Co.'s net worth was maintained at a specified level, and expenditures to provide security to the bank that issued the letter of credit.

Critical to our decision in *Trans World Airlines* were three circumstances. First, the costs held taxable "were costs in lieu of providing a supersedeas bond as provided by the rules." *Id.* at 177 (footnote omitted). We held that the letter of credit served the same purpose as a superse-

deas bond[1] and agreed with the District Court that the fee paid on the letter of credit was an allowable cost of appeal because it was analogous to the bond premium cost authorized by Rule 39(e). The audit and security costs were also held taxable because they served the same purpose as the letter of credit, that is, providing adequate security to T.W.A. Second, the alternate arrangements in lieu of a supersedeas bond were agreed to by the party opposing the appeal and approved by the District Court. *Id.* at 177. Third, the alternative arrangements cost less than a supersedeas bond would have cost. *Id.* at 178.

The District Court in the present action apparently took our decision in *Trans World Airlines* to mean that, even when a supersedeas bond is used, some expenses of obtaining it, in addition to the allowable bond premium, are taxable as costs on appeal. To the contrary, we simply held that costs of appeal that are agreed to and less expensive substitutes for costs explicitly authorized in Rule 39(e) are allowable. That limited ruling is not authority for allowing FDC any portion of its interest expense in borrowing money to collateralize the supersedeas bond. Whether it secured that bond with an asset it owned or with a purchased certificate of deposit, as it hoped to do, or with borrowed cash on which it earned no interest, as it actually did, was not the concern of Lerman.

A court exercising its discretion concerning the imposition of costs where large or unusual expenses are involved should consider whether court approval of the expenses

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1 A letter of credit was used only because the size of the judgment made obtaining a supersedeas bond "impracticable." *Id.* at 175.

was sought before they were incurred.[2] *See* 6 *Moore's Federal Practice* ¶ 54.70[5] (1985). In *Farmer v. Arabian American Oil Co., supra*, the Supreme Court made clear that district judges do not have "unrestrained discretion to tax costs to reimburse a winning litigant for every expense he has seen fit to incur in the conduct of his case." 379 U.S. at 235. Because FDC's borrowing expense, sought in addition to the premium on a supersedeas bond, is not a permissible item of taxable appellate costs, the supplemental judgment of the District Court is vacated. Reversed on the appeal; affirmed on the cross-appeal.

---

2 FDC's contention that Judge Werker approved the interest costs is totally without merit. The statement referred to by FDC to support this contention, taken in context, reveals only that Judge Werker approved of Lerman's bearing the normal cost of a bond, *i.e.*, the bond premium allowed by Rule 39(e).

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
SDNY
81 CIV 2281
GRIESA (0856)

At a stated Term of the United States Court of Appeals for the Second Circuit held at the United States Courthouse in the City of New York, on the twenty-ninth day of April one thousand nine hundred and eighty-six

Present:

HON. ELSWORTH A. VAN GRAAFEILAND,
HON. JON O. NEWMAN,
HON. AMALYA L. KEARSE,
Circuit Judges,

Docket Nos. 85-7775, 85-7961

JACKIE COLLINS LERMAN,
Plaintiff-Appellant-
Cross-Appellee,

—v—

FLYNT DISTRIBUTING CO., INC.
Defendant-Appellee-
Cross-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the Judgment of said District Court be and it hereby is reversed in accordance with the opinion of this court. The cross-appeal from said judgment be and it hereby is affirmed in accordance with the opinion of this court.

A TRUE COPY
ELAINE B. GOLDSMITH
Elaine B. Goldsmith
.....
Clerk

ELAINE B. GOLDSMITH,
Clerk

Edward J. Guardaro
By: Edward J. Guardaro
Deputy Clerk

Opinion of the District Court Dated September 16, 1985, and Supplemental Judgment for Costs Entered Thereon October 3, 1985

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JACKIE COLLINS LERMAN,

Plaintiff,

v.

FLYNT DISTRIBUTING COMPANY, INC.,

Defendant.

OPINION
81 Civ. 7281

GRIESA, J.

At the time I was a Part I judge, an application came before me in connection with defendant's costs of appeal in this matter. One of the items in question was the sum of $183,751. This was the amount of the interest paid by defendant in borrowing $1 million to post as cash collateral with a bonding company to obtain a $1 million supersedeas bond.

On March 5 I ruled that the full $183,751 would not be taxed against plaintiff. The ground of the ruling was that it was unreasonable, under the circumstances shown in the record, to have an arrangement in which $1 million cash was deposited with a bonding company for a period of time without any income being derived from the $1 million which would accrue to be [sic] benefit of defendant. The evidence indicated that defendant made no reasonable efforts to mitigate its loss. Thus I denied the request to tax the full $183,751 interest as costs.

At the conclusion of the March 5 session, after the court had ruled as described above, the defendant requested the opportunity to make a motion for reargument in order to claim a lesser amount than the full $183,751. Defendant suggested that it should be allowed to recover this sum less a reasonable investment return. The court stated that it would entertain such an application.

The application for reargument has now been made. Defendant has shown satisfactorily that a reasonable investment return on the $1 million for the period in question would have been $118,930, representing income on the $1 million at money market rates. The difference between this sum and the $183,751 is $64,821.

The court has the authority to award the amount of the interest expense reasonably incurred to obtain collateral for an appeal bond. *See Trans World Airlines v. Hughes,* 515 F.2d 173, 178 (2d Cir. 1975), *cert. denied,* 424 U.S. 934 (1976). In the present case what was reasonably incurred must be assessed in light of the duty to mitigate. Accordingly, the sum of $64,821 will be taxed in favor of defendant against plaintiff.

Settle an appropriate judgment.

Dated: New York New York
September 16, 1985

Thomas P. Griesa

THOMAS P. GRIESA
U.S.D.J.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JACKIE COLLINS LERMAN,

Plaintiff,

v.

FLYNT DISTRIBUTING COMPANY, INC.,

Defendant.

---

81 Civ. 7281 (HFW)
(Judge Griesa)

Supplemental Judgment for Costs

85, 1759

Upon the Opinion of this Court dated September 16, 1985, it is hereby

ORDERED, ADJUDGED AND DECREED, that defendant, Flynt Distributing Company, Inc., recover from plaintiff, Jackie Collins Lerman, in addition to all sums heretofore recovered by said defendant against said plaintiff, the sum of Sixty Four Thousand Eight Hundred Twenty One and no/100 Dollars ($64,821.00), together with interest thereon from January 17, 1985, calculated as provided in 28 U.S.C. §1961; and it is further

ORDERED, that defendant, Flynt Distributing Company, Inc. have execution hereon as provided by law.

Dated: New York, New York
October 1, 1985

Thomas P. Griesa

U.S.D.J.

Excerpt from July 14, 1983 Colloquy Before District Judge Werker

THE COURT: Wait a minute.

You are saying you will be throwing another million in the pot you will not be able to recoup, but if you have faith in Mr. Rudofsky he says he is going to reverse this decision on verdict on appeal, and if that's the case whatever you pay for that surety bond is going to come out of the plaintiff.

Excerpt from Testimony of Aetna Bond Superintendent James E. Carson at March 5, 1985 Hearing Before District Judge Griesa

Q. Was Aetna involved in the efforts to post substitute collateral?

A. Yes, we were.

Q. Would you please tell his Honor and state for the record what those efforts were, in chronological order, starting with the first effort?

A. The first effort was a certificate—well, we had first talked about a letter of credit and then a certificate of deposit was offered to us from the Bank of America on the West Coast. The certificate of deposit had a flaw, in that it was marked non-negotiable on its face, which prevents us from taking it as collateral in accordance with our policies and practices.

We were then, as I recall, offered a certificate of deposit from Fidelity Bank in Philadelphia. Those negotiations fell through, I believe also because of the non-negotiability of the instrument that was offered.

We at that time referred to Flynt a bank called the Dime Savings Bank in New York as a possible entity who would issue such an instrument that would be acceptable to us, and the instrument eventually issued by the Dime Savings Bank proved to be a twelve-or-so page document, which we also found unacceptable as a negotiable instrument for the purposes of collateral.

Lastly, as I recall, we were offered a—first we were offered a certificate of deposit drawn on the Beverly Hills Bank, which we said we would not take because of the size of the Beverly Hills Bank. And they then offered us a CD drawn by Wells Fargo Bank. The difficulty with that position from our point of view was that the CD had to be held by the Wells Fargo Bank on the West Coast and they would not part with it.

Q. Over what period of time did these negotiations and attempts to substitute interest-bearing collateral for the $1 million cash deposit extend?

A. I would say about a year and a half, perhaps a little less.

* * *

Q. During the course of these attempts by Aetna and Flynt to locate the substitute collateral, did [the] Flynt organization, the Flynt people, at any time take acts or fail to take acts that Aetna requested them to take?

A. No.

Q. Did they in any way act unreasonably or in a commercially unreasonable manner?

MR. DAICHMAN: Objection, your Honor.

THE COURT: Overruled.

A. Not in my opinion, no.

Order of the Court of Appeals Filed and Entered June 19, 1986, Denying Rehearing and Rehearing In Banc

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
Docket No. 85-7775(L)
85-7961

At a stated term of the United States Court of Appeals for the Second Circuit held at the United States Courthouse in the City of New York, on the 19th day of June one thousand nine hundred and eighty-six

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JACKIE COLLINS LERMAN,
Plaintiff-Appellant-Cross
Appellee,

—v—

FLYNT DISTRIBUTING CO., INC.
Defendant-Appellee-Cross
Appellant.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the Defendant-appellee-cross-appellant, Flynt Distributing Co., Inc.,

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
Elaine B. Goldsmith
Clerk

Supreme Court, U.S.
FILED
OCT 10 1986
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 86-446

IN THE

Supreme Court of the United States

October Term, 1986

FLYNT DISTRIBUTING CO., INC.,
Petitioner,

against

JACKIE COLLINS LERMAN,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION

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October 10, 1986

15 pp

Question Presented.

Whether the Court of Appeals erred in determining that the district court misinterpreted a prior Court of Appeals decision to tax as costs excessive and unusual interest expenses for obtaining a loan to collaterialize a supersedeas bond, even though such a cost is not authorized by statute and the only applicable rule limits such cost to the bond premium.

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STATUTE:

Fed. R. App. Proc. 39(e) ..... *passim*

OTHER AUTHORITIES:

6 Moore's Federal Practice ¶54.70[5] (1986) 7

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10 Wright, Miller & Kane, Federal Practice & Procedure 2d §2668 (1983) 7

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986.

FLYNT DISTRIBUTING CO., INC.,

Petitioner,

against

JACKIE COLLINS LERMAN,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION.

Respondent Jackie Collins Lerman respectfully requests that this Court deny the petition for a writ of certiorari to review the unanimous decision of the United States Court of Appeals for the Second Circuit entered on April 29, 1986.

Statement of the Case.

The petition in this case raises no issue worthy of review by this Court. The question presented involves the mundane issue of costs on appeal, and is governed strictly by Rule 39(e) of the Federal Rules of Appellate Procedure rather than by the scant authorities cited by petitioner which predate the enactment of that rule.

Petitioner seeks recovery of $64,821 as the "interest differential" between what it allegedly paid as interest on a $1 million loan used to collateralize a supersedeas bond and the amount it would have earned had the $1 million collateral been invested at prevailing rates rather than sitting idly as it apparently did. Petitioner seeks to hold respondent accountable for this large and unusual cost even though no rule or statute allows it, even though it was never authorized by the district court and even though this potential obligation was never disclosed to respondent at any time prior to the reversal of her judgment.

This litigation originally arose from a claim for violation of respondent's statutory right to privacy by falsely identifying her as a nude starlet and participant in an ogry in a pornographic magazine distributed by the petitioner.

A $10 million judgment, as remitted by the district court, was vacated and reversed in a decision filed on September 10, 1984, in which the Second Circuit held that respondent was a limited purpose public figure but had failed to prove actual malice by clear and convincing evidence. *Lerman v. Flynt Distributing Co., Inc.*, 745 F.2d 123 (2d Cir. 1984), *cert. den.*, ____ U.S. ____, 105 S.Ct. 2114 (1985). The Second Circuit recognized that "the degree of falsity here was severe since plaintiff was not the actress pictured," but held that "constitutional concerns" imposed the unusually high degree of fault which respondent's proof failed to meet. 745 F.2d at 133.

Prior to the reversal of that judgment, petitioner had applied to the district court for a stay of execution pending appeal. Although the district court initially required petitioner to post a $10 million bond as a security for a stay, it later adopted the agreement of the parties that a $1 million supersedeas bond would be acceptable.

The last hearing before the district court concerning the question of security was held on July 14, 1983, and culminated several days of court appearances and negotiations. At the afternoon session of that hearing, petitioner's general counsel David Kahn flew in to New York from California to explain the final solution to the problem:

> Mr. Kahn: First of all, your Honor, I want to thank the Court very, very much for its patience this morning, and its understanding.
>
> The good news is that we have been able to reach an agreement on a million dollar bond which will also serve as the appeal bond, a supersedeas bond * * *
>
> * * *
>
> Let me explain the exact scenario of what is going to be happening. The bonding company wants two things.
>
> No. 1, a letter of credit. And the way we are going to handle that is the bonding company is going to deliver to the Fidelity Bank in Philadelphia their form of letter of credit. At the same time, the bonding company is not satisfied with that, they want also an indemnity agreement from Larry Flynt and from LFP, so the bonding company is going to be sending, hopefully, from their California office to our California office the form of their indemnity agreement.
>
> We are going to make a super effort to get both of these things taken care of tomorrow * * *

No mention was made of any need by petitioner to borrow $1 million. When petitioner's general counsel announced in open court the "good news" that the parties had agreed

upon a $1 million bond and proceeded to describe the "exact scenario" of how that would be accomplished, respondent had every right to expect that the solution of a letter of credit and indemnity arrangement would be the means for obtaining the $1 million supersedeas bond.

The bond was filed in a timely fashion, and respondent heard nothing further about it until over a year later when her judgment was reversed and petitioner sought release of the supersedeas bond. It was only then for the first time that respondent was informed that $1 million had been borrowed and, according to petitioner's general counsel, had been held by the bonding company for over a year without interest.*

In January 1985, the judgment clerk initially refused to allow petitioner to tax any costs because its application was untimely, but the district court subsequently permitted taxation of costs due to petitioner's "excusable neglect." The interest cost was rejected by the clerk's office, but other costs were taxed in petitioner's favor in the amount of $22,701.62, which respondent has paid in full. Included in the costs taxed by the clerk and paid by the plaintiff was $5,312.50 representing the premium charged for the supersedeas bond, an item of costs specifically permitted by Fed. R. App. Proc. 39(e).

When petitioner applied to the district court for relief from the clerk's refusal to tax the interest cost, an evidentiary hearing was held on March 5, 1985. During the course of the cross-examination of a witness from the

*The statement at page 4 of the petition that "there was full disclosure, on the record" of the proceedings before the district court of petitioner's need to borrow $1 million to obtain a bond is inaccurate and misleading.

bonding company, the district court interrupted the proceedings to reject petitioner's application. At the hearing, the district court observed that the $1 million loan was never disclosed to respondent or her counsel until after the case was reversed and the problems encountered in effecting the letter of credit and indemnity arrangement were likewise kept secret from respondent and her counsel. Subsequently, petitioner sought to reargue its motion and present a request for only $64,821 as the "interest differential" rather than the full interest cost of $183,751. Upon petitioner's application for reargument, the district court, without a further hearing and without explaining its reasoning, allowed the "interest differential" of $64,821 to be taxed in favor of petitioner.

Respondent appealed that determination, and it was unanimously reversed by the Second Circuit on April 29, 1986. In its opinion, the Second Circuit recited the security arrangements which had been agreed to by the parties:

> "In describing this agreement to the District Court, FDC's counsel represented that the bond would be backed by a letter of credit. It subsequently developed that FDC could not secure a letter of credit. Instead, without notifying the District Court or Lerman, FDC collateralized a bond issued by Aetna Casualty and Surety Co. with a deposit of $1 million cash that FDC had borrowed" (A3).*

In addition to discussing the relevant facts, the Second Circuit analyzed the case law presented to it as well as the applicable statute, Fed. R. Civ. Proc. 39(e), and concluded that the unusual interest cost claimed "sought in

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*References preceded by "A" are to the appendix to the petition.

addition to the premium on a supersedeas bond, is not a permissible item of taxable appellate costs."

Reasons for Denying the Writ.

Far from raising any issue of conflict among the circuits or an important question of federal law which should be settled by this Court, the petition complains about a decision concerning the routine application of the cost statute.*

This Court has cautioned restraint in taxing unusual costs:

> "[T]he discretion given district judges to tax costs should be sparingly exercised with reference to expenses not specifically allowed by statute." *Farmer v. Arabian American Oil Co.*, 379 U.S. 227, 235 (1964).

Thus, "[c]ourts are to award, except in limited exceptional circumstances, only those expenses specifically recognized by statute." *Illinois v. Sangamo Construction Co.*, 657 F.2d 855, 864 (7th Cir. 1981) (citation omitted). As the court in *Copper Liquor, Inc. v. Adolph Coors Co.*, 684 F.2d 1087, 1099 (5th Cir. 1982), stated in analogous circumstances: "we hold that expenditures for those categories of expenses listed in 28 U.S.C. §1920 may be recovered only if they are allowed by that section."

Fed. R. App. Proc. 39(e) specifically provides for the taxing of only the "premiums paid for the cost of super-

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*There is no issue here of meaningful appellate review in a First Amendment case because petitioner *agreed* to post a bond it could afford in order to stay execution pending appeal.

sedeas bonds or other bonds to preserve rights pending appeal," although Congress was surely aware of other incidental expenses that would necessarily be incurred in obtaining such a bond.* Congress' treatment of the category of appeal bonds without providing for the taxation of related incidental expenses indicates the legislative intent to prohibit the taxation of these other expenses.

The federal cases cited by petitioner, such as *The Europe,* 190 F. 475 (9th Cir. 1911), and *Kemart Corp. v. Printing Arts Research Laboratories, Inc.,* 232 F.2d 897 (9th Cir. 1956) (where the court *denied* the unusual costs expended in obtaining security pending appeal), and *Sunkist Growers, Inc. v. Winckler & Smith Citrus Products,* 316 F.2d 275 (9th Cir. 1962) (where the net borrowing expense allowed was far less than the premium required for a bond), preceded the amended version of Rule 39 and therefore are not controlling. No federal cases have been cited which in any way conflicts with the intent of Rule 39(e) or reveals a conflict among the circuits.

Furthermore, whenever a large or unusual expense is incurred, the courts and commentators have agreed that the better practice is to seek prior judicial approval if the party incurring the expense expects to recover it later as an item of taxable costs. See 6 Moore's Federal Practice §54.70[5] at 54-333 and n.7 (1986); accord, *Shakey's Inc. v. Covalt,* 704 F.2d 426, 437 (9th Cir. 1983); 10 Wright, Miller & Kane, Federal Practice and Procedure 2d, §2668 at 204 (1983). As demonstrated above, rather than disclose to the district court or to respondent the need to borrow $1 million, petitioner misled all concerned by announcing a

*Under the American rule, most major litigation expenses, including attorneys' fees, investigatory services and travel costs, whether or not incurred in connection with a supersedeas bond, are simply not taxable unless otherwise provided by statute.

letter of credit* and indemnity arrangement without even hinting at the prospect of borrowing cash as collateral.

In *Trans World Airlines, Inc. v. Hughes,* 515 F.2d 173 (2d Cir. 1975), *cert. den.,* 424 U.S. 934 (1976), the principal decision relied upon by petitioner below and the only case cited by the district court in awarding the "interest differential," several notable distinctions eliminate that case as support for petitioner's argument.

First, the "letter of credit was obtained, with agreement by the parties, as an *acceptable substitute* for the $75 million bond which would otherwise have been required." 515 F.2d at 177 (emphasis added). Thus, the fee for the letter of credit was taxed instead of the premium for a bond to secure the $145 million default judgment, which bond would have been "impracticable to obtain." *Id.* at 175. In this case, the Second Circuit explained that its decision in *Trans World Airlines* was influenced by the fact that "the letter of credit served the same purpose as a supersedeas bond" and "the fee paid on the letter of credit was an allowable cost of appeal because it was analogous to the bond premium cost authorized by Rule 39(e)" (A6-A7).

Second, the substitute security in *Trans World Airlines* was *consented to* by the parties and *approved* by the

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*The whole point of a letter of credit is to avoid putting up cash. The letter of credit provides a "practical method of financing" by utilizing the issuing bank's credit to "postpone actual payment." N.Y. Jur. 2d, Credit Cards and Letters of Credit, §18 at 304 (1983). A letter of credit "resembles a contract of guaranty" because it "engages the credit of the issuer in support of an indebtedness of the customer to the beneficiary." *Id.* at §19 at 304. Thus, a letter of credit is a commercial device that relies upon *credit* rather than *cash*—there would be no purpose in obtaining a letter of credit if $1 million in cash was available as security.

district court. Here, of course, neither the respondent nor the district court was made aware that petitioner needed to borrow $1 million to collateralize the bond; the only consent given was for a $1 million bond instead of the $10 million bond originally ordered by the district court, and all that was revealed during the post-judgment hearings was that the "exact scenario" for the security arrangements involved a letter of credit together with an indemnity agreement.

Third, the costs allowed in *Trans World Airlines* were in fact "less than a surety bond would have cost and hence in the end—because TWA lost on the appeal—saved it money." *Id.* at 178. See *Sunkist Growers, Inc. v. Winckler & Smith Citrus Products, supra* ($150,776.18 in net interest expense where the total bond premium would have been $240,000). The Second Circuit logically interpreted Rule 39(e) both in the *Trans World Airlines* case and in this case to mean that "costs of appeal that are agreed to and less expensive substitutes for costs explicitly authorized in Rule 39(e) are allowable" (A6).*

It would be especially egregious to tax respondent with costs she could not have anticipated since petitioner misled her and the district court about the actual security arrangements which were undertaken. As the Second Circuit noted, the method for obtaining adequate security "was not the concern of Lerman" (A6) and unless she consented, the district court approved the procedure or the expense was less than what Rule 39(e) allows, the unusual in-

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*In a state case cited by petitioner, *Creed v. Apog*, 377 Mass. 522, 386 N.E.2d 1273 (1979), the court noted that if defendant had not obtained a letter of credit as collateral for a bond, the actual premium cost for the bond would have been higher than the $19,500 expended for the letter of credit.

terest expense was properly rejected. As this Court cautioned in *Farmer v. Arabian American Oil Co., supra,* 379 U.S. at 235, district judges do not have "unrestrained discretion to tax costs to reimburse a winning litigant for every expense he has seen fit to incur in the conduct of his case."

CONCLUSION.

For the foregoing reasons, the petition for certiorari should be denied.

October 10, 1986

Respectfully submitted,

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(3)

86-446

No.

Supreme Court, U.S.
FILED
OCT 25 1986
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

FLYNT DISTRIBUTING CO., INC.,

Petitioner,

v.

JACKIE COLLINS LERMAN,

Respondent.

PETITIONER'S REPLY BRIEF

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October 24, 1986

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

FLYNT DISTRIBUTING CO., INC.,

Petitioner,

v.

JACKIE COLLINS LERMAN,

Respondent.

PETITIONER'S REPLY BRIEF

Reply Argument

I

Respondent concedes *sub silencio* that "regardless of the resolution of the federal constitutional question presented [in *Lerman I*], the extraordinarily excessive $40 million verdict in respondent's favor could not possibly withstand appellate review on a number of grounds, including respondent's counsel's deliberate inflammation of the passion and prejudice of the jury" and a variety of State law grounds,[1] and that respondent, therefore, "unreasonably demanded an excessive bond, far beyond the financial ability of petitioner to post, and grossly disproportionate in view of the lack of merit to respondents' [sic] case." [2]

Instead of explaining why she was entitled to impose even a *plainly unreasonable* $1 million bond requirement upon petitioner, respondent attempts to deflect attention away from her wrongful insistence on a punitive bond and to twist to her advantage the fact that petitioner was unable, despite its undisputed best efforts, to precisely comply with the "scenario" outlined to the District Court by petitioner's

[1] Petition at 3 and 13, n.4.

[2] *Id.* at 13.

General Counsel, namely, that the bond would be secured by a letter of credit.[3] Respondent's arguments are demonstrably specious, however, and should be accorded no weight.

Respondent has *never* attempted to show how, and to what extent, she was allegedly prejudiced by petitioner's inability to secure the bond by posting a letter of credit, and the record is barren of proof of any such prejudice. It is undisputed that petitioner was financially distressed, and therefore would, in any event, have had to borrow $1 million[4] in order to collateralize even a "standby letter of credit" to secure a bond in that sum.[5]

The record is barren of any adverse consequence to respondent by reason of petitioner's inability to procure the contemplated letter of credit as the intermediate step in posting a $1 million bond. Petitioner would have had the expense of borrowing the $1 million regardless of whether

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[3] Brief in Opposition, at 7-9.

[4] Respondent grossly mischaracterizes the record in this regard. Petitioner made full disclosure to the District Court and respondent that a $1 million bond could be secured, "if they [petitioner] have a million dollars to put up," but it was made clear that petitioner did *not* have the ability to secure such an undertaking and that the funds would have to be advanced by petitioner's commercial lender. Respondent has never attempted to explain, much less prove, how petitioner could have possibly obtained either a $1 million surety bond or a $1 million letter of credit, or both, without borrowing $1 million from its lender.

The bonding company's demand for indemnity by petitioner's parent company and its corporate principal, in addition to a bank letter of credit, clearly signals petitioner's financial dilemma. (*See*, District Court colloquy excerpted by respondent [Brief in Opposition, at 3].)

[5] Respondent has never attempted to prove, and has never even claimed, that petitioner could have procured an *unsecured* $1 million bank letter of credit from any reputable lender. *And, see, e.g.*, Dolan, *The Law of Letters of Credit*, ¶12.05[1][b] (1984), at 12-13 ("the careful bank . . . investigates the *creditworthiness of [the] customer* and decides whether to seek *collateral*, guarantees or other protection against default of the customer's obligation to reimburse the bank . . . " in the event the letter of credit is drawn upon) (emphasis added).

deposited with a bank, to collateralize a letter of credit, or (as actually occurred) directly with the bonding company, as the primary collateral for the bond. The only difference would have been (*i*) a bank would have paid interest on the $1 million collateral, whereas the bonding company does not, and (*ii*) petitioner would have incurred bank charges for issuance of the letter of credit, whereas such charges were *not* incurred in this case because a letter of credit could not be obtained despite petitioner's best efforts to do so.[6]

Respondent was not prejudiced by the failure of the bonding company to pay interest in this case because the District Court, faithful to the "careful scrutiny" standard of *Farmer v. Arabian American Oil Co.*, 379 U.S. 227 (1964), awarded *only* the "interest differential" between the interest expenses incurred in the borrowing and the interest which would have been earned at money market rates.[7] Assuming, *arguendo,* that the District Court was correct in mitigating petitioner's damages,[8] its determination clearly mooted any complaint by respondent in this regard.

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[6] Because respondent called no witnesses and introduced no evidence in support of her claims below, the record is barren of any evidence, and the courts below made no findings, as to the ultimate cost differential, if any, between following the "scenario" described by petitioner's General Counsel and the actual course which this case then took. The Court of Appeals summarily rejected petitioner's request for such a determination when it denied, without opinion, the petition for rehearing below.

[7] Respondent's desperate argument that the District Court awarded the interest differential "without a further hearing and without explaining its reasoning" (Brief in Opposition, at 5) is pure sophistry. The motion for reargument raised no disputed issues of fact; the District Court conferenced the matter by telephone to ascertain the parties' respective positions on the motion; no party requested a "further hearing"; and the District Court rendered a formal Opinion, reproduced in the Appendix to the Petition, at A9-10, setting forth its reasoning.

[8] Petitioner argued below that respondent had, and completely failed to satisfy or even attempt to satisfy, the burden of persuasion on her mitigation defense. It is an indication of the lengths to which the District Court went to "carefully scrutinize" the record

(*footnote continued on following page*)

Nor was respondent prejudiced by *lack* of the bank charges which would necessarily have been incurred had it proved possible to obtain the contemplated letter of credit. Such bank charges would only have *increased* petitioner's appellate costs and respondent surely cannot be heard to complain about costs which were *not* incurred.

In light of the District Court's award of only the "interest differential" (rather than the full amount of interest expenses actually incurred by petitioner in order to collateralize and post the supersedeas bond in this case), the discrepancy between the "scenario" allegedly relied upon by respondent and the actual facts is immaterial, since the "interest differential" would have been *the same* in either case and, as events actually took place, petitioner did *not* incur the expense of posting a letter of credit, thereby *reducing* the appellate costs and, because respondent lost on appeal, *actually saving her money*.[9]

Respondent preferred the "scenario" outlined by petitioner's General Counsel in his colloquy with the District Court *not* because it was necessarily less expensive than direct collateralizing of a supersedeas bond (as, indeed, it was not), but because respondent feared that a bankruptcy filing by petitioner would result in recapture of any property pledged directly by petitioner to the bonding company, resulting in cancellation of the bond. Respondent's counsel emphasized

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(*footnote continued from preceding page*)
that it *sua sponte* shifted the burden of proof on this affirmative defense to petitioner, requiring it, and not respondent, to submit the "interest differential" computations below.

[9] Thus, assuming, *arguendo*, that "saving [respondent] money" is anything more than merely one (1) of the factors to be taken into account in the District Court's exercise of discretion, *see, Trans World Airlines, Inc. v. Hughes*, 515 F.2d 173, 178 (2d Cir. 1975), *cert. den.*, 424 U.S. 934 (1976), the award to petitioner in this case met that test, in that the award was (*i*) reduced to the "interest differential" cost which would have been incurred in any case, and (*ii*) petitioner did *not* incur, and respondent was thus not charged with, the cost of the contemplated letter of credit, which was never obtained.

that respondent wanted "real" rather than "illusory" security, and in the circumstances of this case nothing would have been more "illusory" than a supersedeas bond secured by property subject to recapture in the event of petitioner's bankruptcy. The letter of credit "scenario," in comparison, shifted the risk of petitioner's bankruptcy to the bank issuing the letter of credit; the letter of credit would have remained in place regardless of any bankruptcy by petitioner, thereby keeping the supersedeas bond in full force and effect regardless of petitioner's ensuing financial condition.[10]

II

Similarly disingenuous is the argument that "[t]here is no issue here of meaningful appellate review in a First Amendment case because petitioner *agreed* to post a bond it could afford.[11] There was no waiver of petitioner's basic objection to posting a bond and the "agreement" referred to by respondent can only be understood in the context in which it was made, which respondent utterly fails to explain.

Petitioner "agreed" to post a $1 million bond only *after* its motion for a stay pending appeal *without bond* (or, in the alternative, for a bond of no more than $465,000, equal to the highest libel/invasion of privacy verdict ever sustained on appeal to that point in time) was *denied* and the District Court tentatively imposed a *$10 million bond requirement:*

> THE COURT: I'm going to tell you what I'm going to do. I am going to set a bond at this point at *ten million dollars.* I leave it to you gentlement to figure out how you're going to do it, whether it is receivables, real estate, whatever, *cash.*

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[10] Petitioner did *not* file for bankruptcy. Nevertheless, much of the argument during the "bond hearings" centered around the then distinct possibility that it might be forced to do so, with respondent consistently arguing that she not be provided with security which might prove worthless (*i.e.*,"illusory").

[11] Brief in Opposition, at 6, n.* (emphasis in original).

> It could be partially a surety bond, but I want you to come back to me within 48 hours [i.e., by July 13, 1983] and tell me how it is going to be. If it is not done within 48 hours, when I say, "Done within 48 hours," I mean the papers in my hand so that I may sign them, *you may go ahead and execute on your judgment.*
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> * * *
>
> MR. GRUTMAN: [What] His Honor h[a]s given is 48 hours, Mr. Rudofsky. That gives us to the 13[th]?
>
> MR. RUDOFSKY: * * * I presume we should *follow the path that was chart[ed] in the District Court opinion in TWA. We have [go]t to sit down and work it out and report to the court if we possibly can [agree].*
>
> MR. GRUTMAN: If we can't [agree], *we'll have papers here for execution on Wednesday morning at ten o'clock your Honor.*
>
> MR. RUDOFSKY: You have made your point.
>
> (Emphases added.)

Subsequently, respondent was unwavering in her demand for a $1 million bond *plus other security.*[12] The compromise $1 million bond was finally "agreed" upon only under the

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[12] At the initial bond hearing, respondent's counsel's comments included the proposal that respondent would "hold a portion of [petitioner's accounts receivable] *above and beyond the one million dollar bond* . . . . " At the continued hearing, counsel repeatedly struck the same note, for example, "perhaps we can make some arrangement that *builds around the million dollar bond . . . and that adds to the same concept regarding the receiver* . . . . ; and, likewise, "[m]y concern is *a one million [dollar] bond isn't enough* if [petitioner] continue[s] to run the company . . . . " At the same hearing, and to the same effect, petitioner's counsel remarked to respondent's counsel: "[Y]ou want a one million dollar bond . . . *plus a guarantee of all [the] other things[,] of ten million dollars* . . . . "

compulsion of the District Court's prior $10 million bond ruling and the express threat by respondent's counsel of imminent execution of the then-$40 million judgment.[13] The $1 million bond at least protected petitioner from execution of that judgment, and the consequent destruction of its business or bankruptcy which would follow, and preserved its right of appeal.[14] It was in this sense, *and no other,* that the compromise was reported to the District Court after arduous negotiations as "good news."

III

Respondent does not seriously dispute that a result opposite to that below would obtain under the Ninth Circuit cases relied upon by petitioner. Instead, she attempts to avoid the obvious conflict between the circuits by contending that the 1979 amendments to Federal Rule of Appellate Procedure 39 render the line of Ninth Circuit cases relied

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[13] Respondent's excerpting of the "agreement" colloquy between petitioner's General Counsel and the District Court conveniently omits the portion of the colloquy in which petitioner reported, as a material element of the "scenario" upon which respondent claims she relied, that petitioner required until "5 p.m. on Monday," July 18th, in order to obtain the contemplated letter of credit and indemnities required before the bond would be issued. The District Court *refused* to grant the necessary time and arbitrarily ("THE COURT: I am not going to listen to any speech. Get it done.") imposed a deadline of "[t]welve o'clock tomorrow," *i.e.,* Friday, July 15th, despite being expressly advised by petitioner's counsel that "the bank apparently cannot move fast enough" to comply with such a deadline.

Respondent thus could not possibly have relied upon the letter of credit "scenario" unfolding as described, or have been misled in any way, since the District Court itself did not provide enough time for the "scenario" to be carried out, and it was clear *ab initio* that petitioner was going to have to make alternate arrangements for the issuance of the required $1 million supersedeas bond.

[14] As stated in the text, *supra,* there was no waiver of petitioner's basic objection to the posting of a bond (or, in the alternative, a bond greater than $465,000), and despite respondent's out-of-context reference to the $1 million bond "agreement" following the *denial* of petitioner's bond motion, no waiver of this objection is alleged in respondent's brief.

upon by petitioner "not controlling." [15] Neither of the courts below nor any other court has ever so held; respondent cites no authority for her *ipse dixit;* and our research reveals this preposterous view to be respondent's alone.

Professor Moore explains, directly contrary to respondent's argument, that Rule 39 "follows the usual practice in the circuits prior to the promulgation of the Appellate Rules" [*see, e.g., The Europe,* 190 F. 475 (9th Cir. 1911)] and that the 1979 amendments to Rule 39 affected only subdivisions (c) and (d) of that rule, *not subdivision (e). See,* 9 *Moore's Federal Practice,* ¶239.01[i] and [3] (1985). *See, also,* 16 Wright & Miller, *Federal Practice And Procedure,* §3985, p. 381-2 (1986 Supp.).

The authoritative Ninth Circuit cases relied upon by petitioner [and, in the case of *Sunkist Growers, Inc. v. Winkler & Smith Citrus Products,* 316 F.2d 275 (9th Cir. 1962), cited by the Second Circuit in *Trans World Airlines, Inc. v. Hughes, supra*] remain good law and sharply conflict with the rule of law promulgated by the Second Circuit on the appeal below. For this reason alone, certiorari should be granted in order to resolve the conflict among the circuits.

CONCLUSION

For all of the foregoing reasons, as well as those stated in the Petition dated September 16, 1986, a writ of certiorari should issue to review the decision and judgment of the United States Court of Appeals for the Second Circuit in this case.

Respectfully submitted,

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